



NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

JOINT APPLIED PROJECT

PROBLEMS WITH AWARD-FEE CONTRACTS IN THE DEPARTMENT OF DEFENSE

**By: Shemeka S. Ricks,
Tony I. Robertson and
Dennis D. Jolliffe
December 2013**

**Advisors: Matthew Jacobs,
Mike Coburn**

Approved for public release; distribution is unlimited

THIS PAGE INTENTIONALLY LEFT BLANK

REPORT DOCUMENTATION PAGE			<i>Form Approved OMB No. 0704-0188</i>	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington DC 20503.				
1. AGENCY USE ONLY (Leave blank)		2. REPORT DATE December 2013	3. REPORT TYPE AND DATES COVERED Joint Applied Project	
4. TITLE AND SUBTITLE PROBLEMS WITH AWARD-FEE CONTRACTS IN THE DEPARTMENT OF DEFENSE			5. FUNDING NUMBERS	
6. AUTHOR(S) Shemeka S. Ricks, Tony I. Robertson, and Dennis D. Jolliffe				
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Naval Postgraduate School Monterey, CA 93943-5000			8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING /MONITORING AGENCY NAME(S) AND ADDRESS(ES) N/A			10. SPONSORING/MONITORING AGENCY REPORT NUMBER	
11. SUPPLEMENTARY NOTES The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government. IRB Protocol number ____N/A____.				
12a. DISTRIBUTION / AVAILABILITY STATEMENT Approved for public release; distribution is unlimited			12b. DISTRIBUTION CODE	
13. ABSTRACT (maximum 200 words) Award-fee arrangements are a valuable contractual approach for the Department of Defense (DoD) when used properly. Award-fee contracts provide incentives to motivate contractor performance in areas critical to program success that are susceptible to judgmental and qualitative measurement and evaluation. The award-fee process allows the DoD to evaluate a contractor's performance, appropriately recognize accomplishments, and provide a reward. The DoD has the flexibility to develop criteria to evaluate both the performance levels and the conditions under which these levels were achieved during the evaluation period. An award-fee arrangement rewards satisfactory or better performance, provides incentives for the contractor to improve performance, and records the assessment of the contractor's performance. While it is DoD policy to use objective criteria whenever possible to measure performance, there are times when only an incentive based on subjective criteria will achieve the desired objectives. However, subjective evaluations may raise concerns that some award fees are paid but not earned. Lack of DoD acquisition workforce training and experience in utilizing award fee type contracts, coupled with subjective evaluations, may contribute toward award fees being paid even when the contractor does not achieve the desired objectives for which incentives were offered.				
14. SUBJECT TERMS Award-fee contracts, Incentive Contracts, DoD contracting			15. NUMBER OF PAGES 51	
			16. PRICE CODE	
17. SECURITY CLASSIFICATION OF REPORT Unclassified	18. SECURITY CLASSIFICATION OF THIS PAGE Unclassified	19. SECURITY CLASSIFICATION OF ABSTRACT Unclassified	20. LIMITATION OF ABSTRACT UU	

THIS PAGE INTENTIONALLY LEFT BLANK

Approved for public release; distribution is unlimited

**PROBLEMS WITH AWARD-FEE CONTRACTS
IN THE DEPARTMENT OF DEFENSE**

Shemeka S. Ricks, Civilian, United States Army
Tony I. Robertson, Civilian, United States Army
Dennis D. Jolliffe, Civilian, United States Army

Submitted in partial fulfillment of the requirements for the degree of

MASTER OF SCIENCE IN CONTRACT MANAGEMENT

from the

**NAVAL POSTGRADUATE SCHOOL
December 2013**

Authors: Shemeka S. Ricks

Tony I. Robertson

Dennis D. Jolliffe

Approved by: Matthew Jacobs

Mike Coburn

William R. Gates, Dean
Graduate School of Business and Public Policy

THIS PAGE INTENTIONALLY LEFT BLANK

PROBLEMS WITH AWARD-FEE CONTRACTS IN THE DEPARTMENT OF DEFENSE

ABSTRACT

Award-fee arrangements are a valuable contractual approach for the Department of Defense (DoD) when used properly. Award-fee contracts provide incentives to motivate contractor performance in areas critical to program success that are susceptible to judgmental and qualitative measurement and evaluation. The award-fee process allows the DoD to evaluate a contractor's performance, appropriately recognize accomplishments, and provide a reward. The DoD has the flexibility to develop criteria to evaluate both the performance levels and the conditions under which these levels were achieved during the evaluation period. An award-fee arrangement rewards satisfactory or better performance, provides incentives for the contractor to improve performance, and records the assessment of the contractor's performance. While it is DoD policy to use objective criteria whenever possible to measure performance, there are times when only an incentives based on subjective criteria will achieve the desired objectives. However, subjective evaluations may raise concerns that some award fees are paid but not earned. Lack of DoD acquisition workforce training and experience in utilizing award fee type contracts, coupled with subjective evaluations, may contribute toward award fees being paid even when the contractor does not achieve the desired objectives for which incentives were offered.

THIS PAGE INTENTIONALLY LEFT BLANK

TABLE OF CONTENTS

I.	INTRODUCTION.....	1
A.	RESEARCH OBJECTIVES.....	1
B.	ABOUT THE STUDY	3
C.	METHODOLOGY	4
D.	ASSUMPTIONS.....	4
E.	ORGANIZATION OF RESEARCH	4
II.	BACKGROUND	7
A.	INTRODUCTION TO AWARD-FEE CONTRACTING.....	7
1.	Incentive Contracts.....	7
2.	The Purpose and Goals of Award Fee Contracting.....	9
3.	Policies.....	10
4.	Award-fee Pool and Award-fee Plan.....	12
5.	Advantages and Disadvantages	16
III.	CURRENT STATUS AND INITIATIVES	17
A.	OVERALL REVIEW OF THE PROGRESSION OF AWARD-FEE CONTRACTING	17
1.	Ongoing Problems and Trends.....	17
2.	Unpredicted/Unidentified Effects of Award-fee Contracts.....	21
B.	GOVERNMENT ACCOUNTABILITY OFFICE REPORTS.....	22
C.	CONGRESSIONAL LEGISLATION	23
D.	GAO ANNUAL REPORT TO CONGRESS.....	26
E.	INVESTIGATION OF WASTE, FRAUD, AND ABUSE.....	27
F.	DOD TRAINING PROGRAMS FOR AWARD-FEE CONTRACTING	29
IV.	CONCLUSION AND RECOMMENDATIONS.....	33
A.	GENERAL OVERVIEW OF FINDINGS.....	33
B.	RECOMMENDATIONS.....	33
	LIST OF REFERENCES	35
	INITIAL DISTRIBUTION LIST	37

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF TABLES

Table 1. FAR Subpart 16.4—Incentive Contracts15

THIS PAGE INTENTIONALLY LEFT BLANK

LIST OF ACRONYMS AND ABBREVIATIONS

ACA	Army contracting agency
AFARS	Army Federal Acquisition Regulation Supplement
AFP	award-fee plan
CENTCOM	U.S. Central Command
COP	community of practice
CPAF	cost-plus-incentive-fee
D&F	determination and finding
DAU	Defense Acquisition University
DAWIA	Defense Acquisition Workforce Improvement Act
DFARS	Defense Federal Acquisition Regulation Supplement
DFAS	Defense Finance and Accounting Service
DoD	Department of Defense
DOS	Department of State
DPAP	Defense Procurement and Acquisition Policy
EVM	earned value management
EVMIG	Earned Value Management Implementation Guide
FAR	Federal Acquisition Regulation
FFP	firm-fixed-price
FOUO	for official use of only
FPI	fixed-price incentive
G&A	General and Administrative
GAO	Government Accountability Office
HCA	head of contracting activity
IDIQ	indefinite delivery, indefinite quantity
KO	contracting officer (also CO)
KTR	contractor
NTE	not to exceed
OMB	Office of Management and Budget
OUSD	Office of the Under Secretary of Defense
PGI	Procedures, Guidance, and Information

POP	period of performance
PWS	performance work statement
QA	quality assurance
QC	quality control
QCS	Quality Control System
SECDEF	Secretary of Defense
SOW	statement of work
USACE TAC	U.S. Army Corps of Engineers Transatlantic Programs Center
USAID	U.S. Agency for International Development

I. INTRODUCTION

A. RESEARCH OBJECTIVES

Award-fee contracts are used by the Department of Defense (DoD) to achieve specific acquisition objectives by incorporating a financial reward, or incentive, for a contractor to accomplish those objectives. Award-fee contracts are one of the two types of incentive contracting prescribed in the Federal Acquisition Regulation (FAR) 16.4, Defense FAR Supplement (DFARS) 216.4, and relevant material issued in its companion resource, Procedures, Guidance, and Information (PGI) 216.4, which includes Defense Procurement and Acquisition Policy (DPAP) procurement-related guidelines (“Incentive Contracting,” n.d.).

Incentives are designed to motivate or drive the contractor performance in order to meet specific objectives during the period of performance (POP) of the contract. This is accomplished by establishing reasonable and attainable targets that are clearly communicated to the contractor; designing incentives to motivate contractor efforts that might not otherwise be emphasized and devising arrangements that discourage contractor inefficiency and waste. By design, incentives are tightly integrated into overall acquisition strategies for very specific purposes in DoD contracts. By developing incentives, the risk level may be reduced, uncertainty may be reduced, and favorable behavior may be increased throughout a program’s life cycle (Tremaine, 2008).

In accordance with FAR 16.401(a), incentive contracts are described as “appropriate when a firm-fixed-price contract is not appropriate and the required supplies or services can be acquired at lower costs and, in certain instances, with improved delivery or technical performance, by relating the amount of profit or fee payable under the contract to the contractor’s performance” (FAR Subpart 16.4—Incentive Contracts).

There are four (4) factors that can alter the success rate and risk level of fully executing an incentive-type contract in the DoD: (1) funding instability, (2) technology

barriers, (3) leadership changes, and (4) cultural barriers. Individually, each factor can greatly alter the final desired outcome when using incentive-based contracting, and often more than one factor or all of these factors are present (Tremaine, 2008).

According to FAR 16.401(e)(1) Application, an award-fee contract is suitable for use when

1. The work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, schedule, and technical performance;
2. The likelihood of meeting acquisition objectives will be enhanced by using a contract that effectively motivates the contractor toward exceptional performance and provides the Government with the flexibility to evaluate both actual performance and
3. Any additional administrative effort and cost required to monitor and evaluate performance are justified by the expected benefits as documented by a risk and cost benefit analysis to be included in the Determination and Findings references in 16.401(e)(5)(iii).

FAR 16.401(e)(5) Limitations states, “No award-fee contract shall be awarded unless

- All of the limitations in 16.301.3, that are applicable to cost-reimbursement contracts only, are complied with;
- An award-fee plan is completed in accordance with the requirements in 16.401(e)(3); and
- A determination and finding is completed in accordance with 16.401(d) addressing all of the suitability items in 16.401(e)(1).

According to the Office of the Under Secretary of Defense (OUSD) memorandum, “Proper Use of Award Fee Contracts and Award Fee Provisions,” April 24, 2007, the use of award-fee contracting increased in previous years, particularly cost-plus-award-fee (CPAF) contracts. This memorandum states DoD policy for proper use of award fee contracts and provisions, and refers to FAR 16.104 Factors in selecting contract types, which requires assessment of a number of factors to select proper contract type, including “price competition, price analysis, cost analysis, type and complexity of requirement, urgency of requirement, period of performance or

length of production run, the contractor's technical capability and financial responsibility, the adequacy of the contractor's accounting system, concurrent contracts, and the extent and nature of proposed subcontracting and acquisition history." This memorandum further references the suitability of using this type of contract as stated above. (OUSD Memorandum April 24, 2007) (FAR 16.405-2(b))1)(i) in this memorandum, revised to FAR 16.401(e)(1)(i).

The objective of this research project is to evaluate the utilization, execution, and development of award-fee contracts within the Department of Defense (DoD). Is DoD utilizing award-fee contracts as prescribed in FAR Subpart 16.4? This research will be an examination on how effectively and efficiently DoD is applying award-fee contracts, including Fixed-Price and Cost-Plus-Award-Fee contracts. The research will evaluate DoD training, Government Accountability Office (GAO) reports, and the overall application of award-fee contracting. The overall goal is to develop recommendations and alternatives to award-fee contracting based on the research findings.

B. ABOUT THE STUDY

The object of this research project is to focus on how award-fee contracting can actually perform the intended—lower the cost for the Government. How can the contracting field develop or re-develop award-fee contracts to become more effective and more beneficial to the Government?

Below is a list of questions that will be answered and used either to develop alternative methods to apply award-fee contracts, or to identify "best practices" in which the current applications of award-fee contracting have been effective:

1. How can contracting personnel better manage award-fee contracts?
2. Are award-fee contracts really cost-effective for the Government?
3. How can the Government better measure, objectively and quantitatively, the overall performance of the contract?
4. Who is actually benefiting from award-fee contracting – the Government or the Contractor?

C. METHODOLOGY

One method to be used during this project is a literature review on DoD documents pertaining to award-fee contracts. With this information, we will evaluate:

- How well the overall contract was managed:
- Were there any outstanding issues?
- How the contractor was evaluated?
- Were objectives clearly defined?
- Are there any trends?

We will review federal regulations and DoD policies and initiatives pertaining to award-fee contracts. This method will give us a standard that contracting personnel should follow. We want to know whether or not these regulations are understood, utilized, and implemented accurately.

With these methods, we hope to fully understand award-fee contracts and decide whether or not this type of contract is actually beneficial to the Government. Also, it may be determined that this type of contract should be limited to a certain type of requirement or discontinued altogether. We hope to understand the practice of using award fees in order to determine the best method of contracting and to better serve the Government.

D. ASSUMPTIONS

The assumption for this research is that the Department of Defense (DoD) has problems in using and administering award-fee contracts to motivate excellent contractor performance and to achieve desired acquisition outcomes.

E. ORGANIZATION OF RESEARCH

Chapter I is an introduction and a brief discussion of award-fee contracting in the federal government focused on Department of Defense (DoD) contracting methods. Chapter I identifies the research focus and strategy plan by listing the research objectives and questions, describing the methodology used during this research project, and defining key terms.

Chapter II introduces the reader to the history of incentive contracting and the development of award-fee contracting. It defines award-fee contracting and the purpose and goals of this type of contract. Federal acquisition regulations and DoD policies and directives that guide government contracting personnel in appropriate use of this method of contracting will be reviewed.

Chapter III will be a discussion of current-day incentive contracting practices and government policy changes. This chapter will be an overall review of the progression of award-fee contracting—ongoing issues, trends, and overall impact. Also included in this chapter will be reviews of Government Accountability Office (GAO) reports and their findings and recommendations, a literature review of scholarly journals, review of Executive and Congressional actions, and DoD planning and initiatives in award-fee contracting.

Chapter IV will be a compilation of the results and findings gathered throughout the research process. All the research questions listed in Chapter I will be recognized and answered in this section. Also, Chapter IV will serve as the conclusion of this research report, which will provide a general overview of the findings and recommendations for when it is beneficial to the federal government to use award-fee contracting.

THIS PAGE INTENTIONALLY LEFT BLANK

II. BACKGROUND

A. INTRODUCTION TO AWARD-FEE CONTRACTING

1. Incentive Contracts

FAR Subpart 16.401 provides the following guidance for incentive fee contracts:

Incentive contracts as described in this Subpart are appropriate when a firm-fixed-price contract is not appropriate and the required supplies or services can be acquired at lower costs and, in certain instances, with improved delivery or technical performance, by relating the amount of profit or fee payable under the contract to the contractor's performance. Incentive contracts are designed to obtain specific acquisition objectives by

1. Establishing reasonable and attainable targets that are clearly communicated to the contractor; and
2. Including appropriate incentive arrangements designed to
 - (i) motivate contractor efforts that might not otherwise be emphasized; and
 - (ii) discourage contractor inefficiency and waste.

Incentive contracts are used when the pricing risk is not sufficiently large enough to justify the use of a cost-plus-fee contract, but is too great to support the use of a firm-fixed price contract (Cibinic, Nash, & Yukins, 2011). Incentive contracts are considered to be a "middle ground" type of contract. They are to be used when there is little pricing risk to consider, and when pricing for the requirement is too complex or too complicated to determine a fixed price. Incentive contracts hold the contractor responsible for some risks without having all of the responsibility for pricing risks. Both parties to the incentive contract share the risk by basing the contractor's profits on cost or quality of the contractor's performance (Manuel, 2010).

Incentive contracts contain two distinctions: objective and subjective incentives. Objective incentives use a formula that is included in the contract to determine the profit earned by the contractor based on the actual performance results achieved (i.e., Cost-Plus-Award-Fee). For subjective incentives, the Government determines the profit

earned on the contract based on the evaluation of the contractor's performance (i.e., Fixed-Price with Award-fee) (Cibinic, Nash, & Yukins, 2011).

There are several types of incentive contracts, but only the following will be discussed for this report: (1) Cost-Plus-Incentive-Fee, (2) Fixed-Price Incentive, (3) Fixed-Price with Award-fee, and (4) Cost-Plus-Award-Fee contracts. Each type of incentive contract will be discussed briefly.

FAR Subpart 16.405-1(a) describes cost-plus-incentive-fee awards as a "cost-reimbursement contract that provides for the initially negotiated fee to be adjusted later by a formula based on the relationship of total allowable costs to total target costs. This contract type specifies a target cost, a target fee, minimum and maximum fees, and a fee adjustment formula. After contract performance, the fee payable to the contractor is determined in accordance with the formula. The formula is determined by the target cost, and the fee payable increases or decreases depending on whether or not the contractor meets or exceeds the target costs."

Cost-plus-incentive-fee (CPIF) contracts are designed to encourage the contractor to manage the contract effectively. FAR Subpart 16.301-2 Application states that appropriate applications for CPIF contracts are for services or for development and test programs "only when uncertainties involved in contract performance do not permit costs to be estimated with sufficient accuracy to use any type of fixed-price contract" (FAR Subpart 16.301-2). All parties must understand fully the requirement and work to be performed for CPIF contracts to determine reasonable, real-time target costs, and to achieve the results desired from this form of incentive contract.

Fixed-Price Incentive (FPI) contracts are very similar to CPIF contracts. The most significant difference is that FPI contracts include a ceiling price in lieu of the minimum and maximum fees. FAR Subpart 16.403(a) states that a FPI contract "provides for adjusting profit and establishing the final contract price by application of a formula based on the relationship of total final negotiated cost to total target cost. The final price is subject to a price ceiling, negotiated at the outset of the contract" (FAR 16.403(a)).

FPI contracts have two variations: firm target and successive target. A FPI firm target contract is appropriate when the parties can negotiate at the outset a firm target cost, target profit, and profit adjustment formula. This formula will provide a fair and reasonable incentive and a ceiling (firm target) that provides for the contractor to assume an appropriate share of the risk. When the contractor assumes a considerable or major share of the cost responsibility under the adjustment formula, the target profit should reflect this responsibility (FAR 16.403-1).

A FPI successive targets contract “is appropriate when:

1. Available cost or pricing information is not sufficient to permit the negotiation of a realistic firm target cost and profit before award;
2. Sufficient information is available to permit negotiation of initial targets; and
3. There is reasonable assurance that additional reliable information will be available at an early point in the contract performance so as to permit negotiation of either (i) a firm fixed price or (ii) firm targets and a formula for establishing final profit and price that will provide a fair and reasonable incentive. This additional information is not limited to experience under the contract, itself, but may be drawn from other contracts for the same or similar items (FAR 16.403-2(b)).

2. The Purpose and Goals of Award Fee Contracting

The purpose and goals of award fee contracting are to evaluate a contractor’s performance and appropriately recognize certain accomplishments, resulting in a reward for exceptional performance. DoD contracting personnel have the flexibility to develop criteria to evaluate both the performance levels and the conditions under which these levels were achieved during the evaluation period.

The memorandum “Appropriate Use of Incentive Contracts” from the Executive Office of the President, Office of Management and Budget, to Chief Acquisition Officers and Senior Procurement Executives, states “Incentive contracts are used throughout the Federal Government to encourage contractors to perform efficiently and effectively. Using incentives appropriately and applying strong project and acquisition management practices are vital to accomplishing mission needs, minimizing waste, and maximizing value.”

3. Policies

The DoD issues ongoing directives, instructions, and memoranda in order to provide comprehensive contracting policies and improve performance of the defense acquisition system. These policies are formulated and revised for a wide variety of reasons, and are often made in response to or in compliance with Presidential or Congressional acts, regulatory additions and changes, Government Accountability Office (GAO) reports, and Office of Management and Budget (OMB) guidelines.

DoD acquisition policies provide information to guide its workforce, including the military services, program offices, and contracting personnel, and to inform its contractors and industrial partners. As stated previously in this chapter, FAR Subpart 16.4 Incentive Contracts instructs contracting officers and personnel when it is appropriate to use award fee contracts and when to apply it. DFARS Subpart 216.4 Incentive Contracts, along with PGI Subpart 216.4 Incentive Contracts, add further information and guidance to the FAR. Each of these regulatory documents references and complements the others.

As mentioned above, the OMB Office of Federal Procurement and Policy (OFPP) issued “Appropriate Use of Incentive Contracts” in its 2007 memorandum, preceded by “A Guide to Best Practices for Performance-Based Service Contracting” dated October 1998. According to the foreword by Administrator Deidre A. Lee, Performance-Based Service Contracting (PBSC) was “pioneered within the Department of Defense with a great deal of success.” These OMB documents emphasize “objective, measurable performance requirements and quality standards in developing statements of work, selecting contractors, determining contract type and incentives, and performing contract administration.” Along with the FAR, DFARS, PGI, and DoD regulations and directions, they can provide acquisition personnel “help to correct problems commonly associated with services contracts and identified in numerous audits, including cost overruns, schedule delays, failure to achieve specified results, and other performance problems.”

In addition to the above regulations and guidance, the Office of the Secretary of Defense (OSD), the Under Secretary of Defense Acquisition, Technology and Logistics (USD [AT&L]), the Under Secretary of Defense Procurement and Acquisition Policy (USD [DPAP]), and leaders of the military services issue directives, instructions, and memoranda covering policies and procedures focused on compliance with regulations, attention to recommendations, assessments of problems, and strategies for improvements.

In a memorandum issued April 24, 2007 by the Office of the Under Secretary of Defense, the Director of Defense Procurement and Acquisition Policy discussed the proper use of award fee contracts and award fee provisions. In this memorandum, Director Shay D. Assad reminded everyone of the criteria and objectives that need to be met before establishing a CPAF contract by restating FAR 16.104 and FAR 16.405-2 (b)(1)(i). Director Assad emphasized that it is DoD policy to utilize objective criteria whenever possible to measure contract performance. When it is determined that objective criteria for cost, technical performance, or schedule do not exist, then it is suitable to use a CPAF contract. In this memorandum, the Head of the Contracting Activity (HCA) is directed to sign a determination and finding (D&F) that “the work to be performed is such that it is neither feasible nor effective to devise predetermined objective incentive targets applicable to cost, technical performance or schedule.” Also, the directive allows the HCA to delegate approval authority one level below them in the contracting organization (Assad, 2007).

DoD Instruction 5000.02 “Operation of the Defense Acquisition System” (to implement DoD Directive 5000.1) was issued by the USD (AT&L) to the OSD, Military Departments, and all organizational entities within the DoD (December 8, 2008). This Instruction includes very specific responsibilities for defense acquisition executives and program managers to be accountable for cost, schedule, and performance reporting. It includes specific information regarding the structure of acquisitions and states, “Contractors are entitled to earn reasonable rewards on DoD contracts, including competitively awarded contracts.”

Also included in DoD Instruction 5000.2 is a chart for Earned Value Management (EVM) for all contract types, and reference to the DoD Earned Value Management Implementation Guide (EVMIG) Section 2.5.3 Award Fee Contracts. This Guide reiterates the general concept of award fee contracting and says, “Award fee criteria should be carefully selected to properly motivate the contractor’s management and performance during the award fee period. Qualitative criteria are generally recommended, but clear distinctions should be established between the performance levels to guide the Program Management Office (PMO) when evaluating performance.” Also, the Guide states, “If such qualitative criteria are difficult to support during the evaluation process, the PMO should consider using subjective criteria for EVM performance results” (“Earned value management implementation guide,” October 2006).

Along with all of the regulations and resources included above, comprehensive information about DoD acquisition policies is readily available on the Department of Defense OSD, AT&L, DPAP, and OMB websites, including guidelines for selecting contract types including award fee, writing a statement of work (SOW) and performance work statement (PWS), job analysis, quality assurance (QA) plan and surveillance, contract administration, and conflict resolution.

As stated previously in this chapter, FAR Subpart 16.4 Incentive Contracts instructs Contracting Officers and personnel when it is appropriate to use award-fee contracts and when to apply it. Procedures, Guidance, and Information (PGI) 216.401 Incentives Contracts, and Defense Federal Acquisition Regulation Supplement (DFARS) Subpart 216.4 Incentives Contracts, add DoD incentive contracting regulations to the FAR. Each regulatory document both references the other and complements the established regulations.

4. Award-fee Pool and Award-fee Plan

The DFARS 216.4 and PGI 216.4 elaborate on the established objectives and criteria for award-fee contracts listed in the FAR. Both the DFARS and PGI list in more

detail the requirements for an award-fee plan, award-fee pool, and award-fee evaluation and payments. DFARS 216.405-2, Cost-plus-award-fee contracts, states:

1. *Award-fee pool.* The award-fee pool is the total available award-fee for each evaluation period for the life of the contract. The contracting officer shall perform an analysis of appropriate fee distribution to ensure at least 40 per cent of the award fee is available for the final evaluation so that the award fee is appropriately distributed over all evaluation periods to incentivize the contractor throughout performance of the contract. The percentage of award fee available for the final evaluation may be set below 40 per cent if the contracting officer determines that a lower percentage is appropriate, and this determination is approved by the head of the contracting activity (HCA). The HCA may not delegate this approval authority.
2. *Award-fee evaluation and payments.* Award-fee payments other than payments resulting from the evaluation at the end of an award-fee period are prohibited. (This prohibition does not apply to base-fee payments.) The fee-determining official's rating for award-fee evaluations will be provided to the contractor within 45 calendar days of the end of the period being evaluated. The final award-fee payment will be consistent with the fee-determining official's final evaluation of the contractor's overall performance against the cost, schedule, and performance outcomes specified in the award-fee plan.

PGI 216.405-2 guidance states when it is appropriate to utilize cost-plus-award-fee contracts:

4. The cost-plus-award-fee contract is also suitable for level of effort contracts where mission feasibility is established but measurement of achievement must be by subjective evaluation rather than objective measurement.

Also, PGI 216.405-2 gives the contracting activity some guidance on establishing a board to determine the award-fee amount:

5. The contracting activity may
 - (i) Establish a board to
 - (A) evaluate the contractor's performance; and
 - (B) determine the amount of the award or recommend an amount to the contracting officer; and
 - (ii) Afford the contractor an opportunity to present information on its own behalf.

PGI 216.4 also provides an example of performance evaluation criteria and the contractor's evaluation report. Both of these forms will be discussed further in the following section of this chapter.

Currently, the usage of cost reimbursement contracts has been in the public eye since the Bush administration. In the present Obama administration, firm-fixed price contracts are preferred, and cost reimbursement contracts are to be considered as a last resort. The current standings of award-fee contracting will be discussed in more detail in Chapter III.

Under FAR 16.401(e)(2), the award-fee amount shall be allocated with these factors: (1) the contractor's overall cost; (2) schedule; and (3) technical performance measured against the contract requirements criteria stated in the award-fee plan. The methodology for determining the award fee shall be at the discretion of the Government. The contractor cannot be awarded the award fee if the three factors (listed above) are not at a satisfactory level.

Award-Fee Adjectival Rating	Award-Fee Pool Available To Be Earned	Description
Excellent	91%-100%	Contractor has exceeded almost all of the significant award-fee criteria and has met overall cost, schedule, and technical performance requirements of the contract as defined and measured against the criteria in the award-fee plan for the award-fee evaluation period.
Very Good	76%-90%	Contractor has exceeded many of the significant award-fee criteria and has met overall cost, schedule, and technical performance requirements of the contract as defined and measured against the criteria in the award-fee plan for the award-fee evaluation period.
Good	51%-75%	Contractor has exceeded some of the significant award-fee criteria and has met overall cost, schedule, and technical performance requirements of the contract as defined and measured against the criteria in the award-fee plan for the award-fee evaluation period.
Satisfactory	No Greater Than 50%	Contractor has met overall cost, schedule, and technical performance requirements of the contract as defined and measured against the criteria in the award-fee plan for the award-fee evaluation period.
Unsatisfactory	0%	Contractor has failed to meet overall cost, schedule, and technical performance requirements of the contract as defined and measured against the criteria in the award-fee plan for the award-fee evaluation period.

Table 1. FAR Subpart 16.4—Incentive Contracts

An award-fee pool is the total award-fee amount available throughout the entire contract period (base plus options) for each evaluation period. With each evaluation period, the contractor has not earned any percentage of the award fee, but starts with 0% and works toward 100%.

There is no FAR requirement published about how to establish the amount to be held in the award-fee pool. In the acquisition process, parties involved in the procurement must analyze the complexity of the requirement and develop an award-fee amount logically.

As stated previously in this chapter, FAR Subpart 16.4 Incentive Contracts instructs Contracting Officers and personnel when it is appropriate to use award-fee contracts and when to apply it. The Defense Federal Acquisition Regulation Supplement (DFARS), and its companion resource Procedures, Guidance, and Information (PGI) 216.401 Incentives Contracts, add DoD incentive contracting regulations to the FAR. Each regulatory document both references the other and complements the established regulations.

5. Advantages and Disadvantages

The advantages of award-fee contracting are that they are designed to encourage the contractor efforts toward exceptional performance in areas critical to program success, and are utilized to discourage waste and inefficiencies. They also afford acquisition personnel to have the flexibility to develop criteria to evaluate both the performance levels and the conditions under which these levels were achieved during the evaluation period.

The disadvantages of award-fee contracts arise from the necessity of having experience and knowledge to apply incentives appropriately, and the subjective nature of evaluating performance accurately. Subjective evaluations may result in payment of award fees when they were not earned, because they have not achieved the desired objectives for which they were offered.

As reviewed in the OUSD Memorandum, “Proper Use of Award Fee Contracts and Award Fee Provisions,” there are many factors that must be considered in selecting the proper contract type, including: price competition; price and cost analysis; requirement type; complexity and urgency; period of performance; the contractor’s technical capability, financial responsibility, and accounting system; concurrent contracts; extent and nature of proposed subcontracting; and acquisition history. Evaluating all of these factors is a considerable task, and is based on subjective judgments that may be influenced or biased.

III. CURRENT STATUS AND INITIATIVES

A. OVERALL REVIEW OF THE PROGRESSION OF AWARD-FEE CONTRACTING

1. Ongoing Problems and Trends

Award-fee contracting has not driven performance outcomes in federal government contracting as expected, particularly in the past decade. Ongoing problems received a great deal of attention due to the failure to achieve desired outcomes, and reached a high point in DoD contracting for Iraq and Afghanistan. The resultant GAO and Inspector General reports, along with research conducted by public and private organizations and individuals, received considerable attention and contained many proposals and recommendations for change.

Ongoing problems and issues that are challenges to using this type of contract are included in a Summary of Consensus Views from a research effort requested by the USD (AT&L) in response to GAO-06-66, “DoD Has Paid Billions in Award and Incentive Fees Regardless of Acquisition Outcomes.” The goal of this research was “to investigate where the acquisition community implemented award and incentive fee practices that had a favorable impact on performance outcomes and could be adopted as best practices throughout the acquisition community.” The summary highlighted these problems and issues:

1. Government construction of the award fee plan (including metrics, incentives, etc.) may not link with the offeror’s proposed solution or motivations.
2. Industry welcomes the use of base fee to better delineate the difference between “best efforts” (e.g. base fee) and “excellence” (award fee).
3. In some cases, the government does not follow its own policies on award fee.
4. On occasion, award fee evaluation criteria are poorly explained or justified and communication of award fee goals and criteria are not clearly explained.

5. It is difficult to establish the relationship between awards for month-to-month activities to the goals of a multiple-year program. The linkage is not always apparent.
6. Administration of award fee criteria can change in post award and create problems during contract execution.
7. Government personnel are not always adequately trained in managing award fee contracts.
8. Post-award administration of award fee contracts is time and resource intensive.
9. Desired outcomes are not always driven by the award fee because of insufficient funds available and subjectivity of the final evaluation.
10. There are sometimes inconsistencies in the timing of the award fee in line with the evaluation criteria.
11. Government and contractors sometimes have different perceptions of the purpose of award fees.
12. In some cases, there is government failure to understand the economics of defense contracting and its impact on government contractors
13. From time to time, there is inappropriate use of award fee contracts.
14. Requirements are sometimes too subjective and do not measure outcomes that are sought by the DoD. (Gilbreth & Hubbard, July 2008)

Administration and oversight of award-fee contracts are complex processes that require large amounts of time and attention, and can easily become a source of problems. The most challenging problems for DoD personnel are time, training, and experience, particularly in today's government climate of sequestration, furloughs, and budget cuts. The laws, regulations, guidance, instructions, and directives to be followed in any acquisition are almost infinite. Along with applying this information, contracting personnel must understand requirements, conduct market research, prepare proposals, solicit bids, and fulfill their administrative responsibilities. Because award-fee contracts require significant time and effort to administer, all of these factors must be considered prior to making a decision to use this type of contract. Consideration of the resources necessary must include not only the experience, workload, and availability of contracting personnel, but also the contracting officer, monitors, program managers, award-fee evaluation board members, and award-fee determination official.

GAO reports on award-fee contracts generally have the same conclusions about problems in award-fee contracts: award-fee plans not properly developed, award-fee plans not properly followed, award fees not properly documented, award-fee information missing from contract files, and “lessons learned” not shared among agencies and military services. GAO reports recommend following FAR and DFARS guidance, along with utilizing OMB guidance and requests for more comprehensive guidance from DoD leaders, rather than specifically recommending training for acquisition personnel.

The deficiency in training with regard to award-fee contracts does not end with acquisition personnel because personnel involved with award-fee board also should be trained. When the award-fee board meets to evaluate and discuss the award-fee for the period they need to understand what they are actually required to perform. All too often the award-fee board will receive presentations from the contractor, reporting their self-evaluation, from government quality assurance personnel reporting their findings on what they have observed during the evaluation period, and from others relevant to contractor performance during the period, not fully knowing exactly how they are to use the information that is presented. Should they put much stock in the contractor’s self evaluation? Should they blindly follow the quality inspector’s reports, or can they use only this information? Experience tells that the contractor will always accentuate positive aspects of their performance while marginalizing negative aspects, but it’s not uncommon for positive aspects of contractors’ performance to be marginalized by quality assurance/evaluation personnel. Although some items are addressed in the Award-fee Plan, board members need to receive training so they know exactly what information they are supposed to use and how to use the information. On the surface observations and inspections from assurance personnel would seem to be all the information that would be required, but many evaluation factors are concerned with operating activities other than performance, reporting, cost/price, and others. GAO reported that between 2004 and 2008 approximately \$9 billion in award-fees were paid to contractors, some of which was paid to contractors that received unsatisfactory ratings.

Many acquisition personnel don't get the opportunity to work with award-fee contracts often, if at all, making experience with award-fee contracts somewhat difficult to obtain. Some contracting offices are staffed with very experienced personnel that have worked with award-fee contracts, but some are staffed with relatively new acquisition personnel that have not had the opportunity to experience planning, developing and/or administering award-fee requirements. Lack of experienced personnel accompanied by a general shortage of manpower across the workforce lends to situations in which it is not uncommon for inexperienced personnel to be given a contract and be expected to hit the ground running. This poses a particular problem with award-fee contracts, due to the amount of oversight required and a nature that can be fairly complex, it is not always easy to readily identify exactly what should be done without at least some experience with the subject. The only solution to this situation is to provide developmental training.

Some award-fee contracts within DoD have been awarded using evaluation factors as illogical as development of contractor personnel rosters being used as an evaluation factor. Meaning the contractor simply keeping the government supplied with an updated personnel roster was an evaluation factor for the award-fee. Given the evaluation factor in question was for a contract for facilities support services, not in a combat operations area, it is easy to determine that the personnel roster, although it may be required, is not important to successful contract performance, nor does it add any measurable value to the government. Items such as personnel rosters and similar documents may be required by the contract but are not factors that affect contract performance; hence they should not be considered for use as evaluation factors of award-fees. This particular evaluation factor presents multiple problems. Beyond the fact that this evaluation factor does not have the ability to encourage or inspire the contractor to perform in an exceptional manner, it is not measurable in any meaningful manner, which is a primary concern when developing evaluation factors. Items such as personnel rosters are simply done or not done, pass or fail. Although the argument could possibly be made that the rosters were delivered to the government earlier than

required or more often than required to demonstrate the contractor performing at a higher level, the argument is weak at best, and is a clear example of actions to avoid.

2. Unpredicted/Unidentified Effects of Award-fee Contracts

Award-fee contracts allow for a high level of communication to occur between the contractor and the government. Award-fee contracts involve the government giving contractors' detailed evaluations of their performance, identifying issues as they arise, as a result the contractor should be able to improve performance on a constant basis for the life of the contract. Unless the contractor feels the government analysis is wrong, in which case communication can determine if the government is wrong and why. In either case the contracting parties are forced to analyze performance on a regular basis and communicate with each other regarding any problems. This communication should provide for the best possible performance, yet this process can breakdown do to complacency and inattention to desired outcomes

Evaluators are usually government personnel working closely with the contractor monitoring the contractor's performance. This can lead to a situation in which the contractor follows an evaluator's direction in order to earn higher award-fees, even though the evaluator is not authorized to obligate the government and the contractor knows this fact. This type of action typically increases contract cost and can lead to Anti-Deficiency Act violations. When this occurs the contractor feels that they are providing excellent service to the government, going above and beyond the terms of the contract; however, this is an example of actions that are just the opposite of excellent performance, because it undermines cost efficiency and violates contract terms and condition, federal regulations and statutes.

Some issues have been identified when government evaluators give high ratings to contractors due to personal relationships. Government personnel overseeing contracts work closely alongside contractor personnel working on contracts. It is human nature for people working close together to form relationships and even friendships. This in itself is not a problem. The problem arises when the personal relationship affects the professional relationship. It can be difficult for some evaluation personnel to

give a low award-fee rating due to the perception that a low rating will negatively affect the relationship with a friend that works for the contractor being rated. This represents a clear conflict of interest that must be addressed.

B. GOVERNMENT ACCOUNTABILITY OFFICE REPORTS

The Government Accountability Office (GAO) conducts financial audits and provides investigative reports to help analyze federal expenditures of taxpayer dollars. According to its current mission statement, the agency exists to support Congress in meeting its constitutional responsibilities, and to help improve performance and accountability of the federal government for the benefit of the American people.

GAO investigations of the Department of Defense report problems about spending and provide audits, and may be influenced by requests from members of Congress. The reports contain recommendations regarding DoD contracting practices, and often result in DoD leaders reiterating policies, or in formulating new or increased guidance to its workforce.

Several GAO reports in the past decade have had substantial impact on the criticism of DoD expenditures, resulting in increased public and legislative scrutiny. It is evident from the resultant DoD actions to provide more comprehensive guidance, along with an increase in its requirements for hiring and training acquisition personnel, that these reports have had a positive affect in addressing problems in contracting. The most influential GAO reports regarding problems with DoD award-fee contracts include:

GAO-09-839T, “FEDERAL CONTRACTING Application of OMB Guidance Can Improve Use of Award-fee Contracts” dated August 2009, was testimony to several Congressional committees. This report discusses problems that have been identified and makes recommendations to correct improper usage of award-fee contracts. Practices that are inconsistent with OMB guidance aimed at improving the use of award-fee contracts are identified specifically, including: limiting the use of rollover of award fees; linking award fees to performance outcomes; using evaluation factors to motivate performance; and eliminating award fee payments for unsatisfactory

performance. Although this report covered five separate government agencies, only discussions of DOD are relevant to this project. Accordingly, it was the primary recommendation in GAO-009-839T to follow existing OMB guidance and policy for award fees.

This report was preceded by GAO-09-630, “FEDERAL CONTRACTING Guidance on Award Fees Has Led to Better Practices but Is Not Consistently Applied” dated May 2009, which was requested by members of Congress. This request asked GAO to “identify agencies’ actions to revise or develop award-fee policies and guidance to reflect OMB guidance, assess the consistency of current practices with the new guidance, and determine the extent agencies are collecting, analyzing, and sharing information on award fees.” The report resulted in a recommendation for the DoD to promote application of its current guidance, and for all agencies in the report to work together to develop methods to evaluate the effectiveness of award fees and share successful strategies.

GAO-06-66, “DEFENSE ACQUISITIONS DOD Has Paid Billions in Award and Incentive Fees Regardless of Acquisition Outcomes” dated December 2005, was a report to the Congressional Subcommittee on Readiness and Management Support, Committee on Armed Services. It discussed the DoD’s misuse of award-fee contracts, and reported that award fees were paid for unsatisfactory evaluations and were “rolled over” to give contractors multiple attempts to receive unpaid award fees. The GAO recommended in this report that the DoD improve use of award fees by tying them to specific outcomes for all incentive contracts. Further recommendations were for the DoD to collect and share data to support the effectiveness of award fees. `

C. CONGRESSIONAL LEGISLATION

Congress enacts legislation for DoD budgeting, contracting, and force structure. There is Congressional legislation throughout history that addresses acquisition policy and management, and establishes requirements for DoD acquisition workforce training, including legislation for the management and oversight of contractors. Contractors often account for 50% or more of total personnel in military operations, and are used to

provide services such as construction, base support, specialized expertise, and private security. One of the most beneficial aspects of contracting for support of the DoD is prompt response to emerging needs or contingencies, and cost savings from hiring contractor personnel only when their services are required.

The Congressional Research Service prepares reports regarding problems in DoD contracting, and raises potential questions to be considered by legislators. Effective use and management of contractors undergoes scrutiny by many members of Congress, and often results in inquiries and hearings. The National Defense Authorization Acts for FY2007-FY2013 contain some of the most comprehensive legislation covering DoD budgeting, contracting, force structure, acquisition policy, and workforce training, as follows (by year of enactment):

2006

- Directed DoD to develop joint policies for requirements definition, contingency program management, and contingency contracting.

2008

- Required contingency contracting training for non-acquisition personnel within DoD.
- Established the Defense Acquisition Workforce Development Fund.
- Required DoD, Department of State (DOS), and the U.S. Agency for International Development (USAID) to agree upon a central database for contract information
- Directed DoD to develop regulations on the selection, training, equipping, and conduct of private security contractors.
- Authorized five Joint billets for General/Flag Officer to serve in acquisition positions.
- Required DoD to establish policy to ensure proper development, assignment, and employment of military acquisition personnel.

2011

- Established a Government-wide contingency contracting corps to support domestic and overseas operations.

- Established oversight and accountability mechanisms for private security contractors in significant areas of military operations.
- Required DoD to review standards and certification of private security personnel.
- Required DoD to establish policy to ensure proper development, assignment, and employment of civilian acquisition personnel.

2012

- Amended the definition of a contingency operation.
- Required DoD to address contractor support in the Quadrennial Defense Review.
- Required DoD to amend the Defense Federal Acquisition Regulation Supplement (DFARS) to prohibit contracting with the enemy in the U.S. Central Command.
- Required DoD to amend the DFARS to allow access to the records of contractors and subcontractors in U.S. Central Command.
- Granted authority for DoD to use ‘reachback’ contracting authority to support overseas contracting in Iraq and Afghanistan.

2013

- Extended expedited hiring authority to fill shortages in DoD’s acquisition workforce through 2017.
- Required DoD to issue guidance on responsibility and authority for operational contract support policy, planning, and execution.
- Required DoD, DOS, and USAID to issue guidance regarding data collection on contract support for future overseas operations.
- Mandated the inclusion of operational contract support in certain requirements for DoD planning, joint professional military education, and management structure.
- Required Combatant Commanders to develop a contractor reliance risk assessment and risk mitigation strategy for operational or contingency plans.
- Described responsibilities of inspectors general during overseas contingency operations.
- Updated the responsibility of senior acquisition personnel within DoD, DOS, and USAID for contingency contracting and contract oversight.

- Required agencies to establish and maintain a database on price trends of items and services under Federal contracts.
- Required DoD, DOS, and USAID to have independent suspension and debarment officials.
- Stipulated uniform contract writing system requirements.
- Enhanced the responsibilities of the Chairman of the Joint Chiefs of Staff regarding the inclusion of operational contract support in National Military Strategy. (CRS Analysis of National Defense Authorization Acts for FY2007-FY2013) (CRS7-5700, May 2013)

This recent Congressional legislation illustrates the wide-ranging requirements and regulations for DoD contracting, and highlights the extensive requirements for training of personnel involved in contracting. At the same time, budget cuts for the DoD have been mandated as well, creating problems for leaders and managers in allocating resources.

D. GAO ANNUAL REPORT TO CONGRESS

GAO's first annual report to Congress resulted from a new statutory requirement for GAO "to identify federal programs, agencies, offices, and initiatives, either within departments of government-wide, which have duplicative goals or activities. The report, GAO-11-318SP, "Opportunities to Reduce Potential Duplication in Government Programs, Save Tax Dollars, and Enhance Revenue" dated March 2011, addresses cost-saving or revenue-enhancement opportunities for many government agencies and programs, including the DoD. It includes detailed information to address problems in "Adherence to New Guidance on Award Fee Contracts Could Improve Agencies' Use of Award Fees and Produce Savings."

The report describes "significant disconnects between program results and fees paid." In its research, the GAO found that award-fee guidance was not consistently followed, nor were there methods employed for evaluating the effectiveness of award fees as tools for improving contractor performance. The recommendations correspond with those provided in the August 2009 testimony to Congressional committees, GAO-

09-839T, “FEDERAL CONTRACTING Application of OMB Guidance Can Improve Use of Award-fee Contracts.”

GAO-11-318SP restates three primary issues that could improve the use of award fees and produce savings: (1) award fees are not always linked to outcomes, (2) payments are made despite unsatisfactory contractor performance, and (3) award fee “rollover” allows contractors to earn previously unearned fees in one evaluation period to be rolled over to subsequent periods, allowing additional opportunities. As recommended and reported previously in GAO-09-839T, lack of adherence to OMB guidance and established policy, along with a change in practices to conform to revisions and amendments in the FAR, are identified as causes for problems with award-fee contracts in the DoD.

The report does mention savings that were achieved by the DoD by using metrics for software performance, warfighter capability, and cost control that had used less defined criteria previously in the Joint Strike Fighter program, resulting in an estimated \$29 million less in award fees. It also cites instances in which the DoD prohibited award fees for unsatisfactory performance in a satellite program for the Air Force, resulting in an estimated \$10 million saving.

GAO11-318SP addresses the practice of rollover and advocates limiting its use “to exceptional circumstances to avoid compromising the integrity of the award fee process.” Also addressed are the amendments to the FAR prohibiting the practices of rollover of unearned award fees and awarding fees to contractors that have performed unsatisfactorily. It also supports the DoD peer review process for examining contracts over a certain dollar threshold for administering award fees.

E. INVESTIGATION OF WASTE, FRAUD, AND ABUSE

Many of the most significant problems with award-fee contracts in the DoD were reported in audits pursuant to The National Defense Authorization Act for Fiscal Year 2008, Section 842, “Investigation of Waste, Fraud, and Abuse in Wartime Contracts and Contracting Processes in Iraq and Afghanistan,” January 28, 2008. Section 842 requires thorough audits “to identify potential waste, fraud, and abuse in

the performance of (1) Department of Defense contracts, subcontracts, and task and delivery orders for the logistical support of coalition forces in Iraq and Afghanistan; and (2) Federal agency contracts, subcontracts, and task and delivery orders for the performance of security and reconstruction function in Iraq and Afghanistan.”

An excellent example of these audits was provided by the DoD Assistant Inspector General for Acquisition and Contract Management, “U.S. Army Corps of Engineers’ Use of Award Fees on Contracts in Iraq and Afghanistan” (Report D-2010-049) issued April 2010. The objective of this report was to evaluate procedures used by the U.S. Army Corp of Engineers (USACE) Transatlantic Programs Center (TAC) for determining and awarding fees on 15 cost-plus-award-fee (CPAF) task orders worth approximately \$116.4 million. These task orders were for indefinite delivery, indefinite quantity (IDIQ) contracts for construction-related services throughout the U.S. Central Command (CENTCOM) in Iraq and Afghanistan. TAC is responsible for providing engineering, construction, and contracting services to the CENTCOM.

The report states that personnel responsible for contracting and award fees did not properly manage and oversee the award-fee process. Awards are usually for base years and option years. Minimum and maximum quantity limits are specified in the basic contracts. In this case, however, “officials did not:

- develop adequate award-fee plans for incentivizing and evaluating contractor performance,
- adequately conduct oversight and evaluation responsibilities, or
- adequately document and support award-fee ratings.”

According to the report, this outcome occurred because “USACE did not have policies and procedures for administering award fees consistently and in accordance with Federal Acquisition Regulation requirements” and “did not adopt Army best practices documented in the Army Contracting Agency (ACA) Award Fee Contracts Handbook.” It identifies that TAC did not establish effective procedures for administration and oversight of these CPAF task orders. Also, the report reiterates that

internal controls were necessary and required under DoD Instruction 5010.40, “Managers’ Internal Control (MIC) Program Procedures.”

The report also acknowledges there were inadequate resources that were not consistently available to properly administer these task orders. Subsequently, the Principal Assistant Responsible for Contracting-Winchester (PARC-WIN) put a moratorium on the use of award-fee contracts, and required Contracting Officers to request approval for their use by submitting justification that included cost-benefit analysis. It was noted that, as a result, the number of award-fee contracts was substantially reduced.

Recommendations in the report were for the Director, National Contracting Organization, Headquarters, USACE, in coordination with the PARC-WIN, to develop standard operating policies and procedures for administering effective award-fee programs. These procedures were recommended to provide additional detail to the guidance in the FAR, DFARS, Army Federal Acquisition Regulation Supplement (AFARS), and the Army Contracting Agency (ACA) Award-fee Contracts Handbook. It was determined they were necessary to establish requirements for cost-benefit analysis and for determining the availability and adequacy of resources to correct weaknesses in the administration of award-fee contracts at TAC.

It was recommended that the policies and procedures address, at a minimum:

- development of (AFPs) adequate for motivating and overseeing contractor performance,
- key award fee functions for proper oversight and evaluation of award-fee contracts, and
- the documentation needed to support award-fee ratings.

F. DOD TRAINING PROGRAMS FOR AWARD-FEE CONTRACTING

Current training programs for award-fee contracting for DoD acquisition personnel depends on several variables. These include availability of time, the type of contracting required for a particular agency or military service, understanding the agency or service incentive philosophy consistent with the FAR and DFARS, and the availability of coursework based on personnel career track requirements. Training for

all of today's DoD workforce reflects increasing demands for skilled employees with high levels of expertise.

DoD acquisition personnel must have relevant education and applicable experience to be hired. Employees are informed of training objectives and requirements before they are hired, and must complete ongoing mandatory training as directed. There are three levels of training required to obtain certification in contracting, and to be eligible for retention and advancement. Coursework is fulfilled through Defense Acquisition University (DAU), and some contracting employees are required to obtain a Masters degree in Acquisition and Contracting Management that is offered by the Naval Postgraduate School (NPS).

Current DAU and NPS coursework topics for acquisition personnel include: Federal Acquisition Regulations (FAR) Fundamentals, Contracting Fundamentals, Principles of Acquisition and Program Management, Economics for Managers, Contract Law, Cost and Price Analysis, Business Decisions for Contracting, Legal Considerations in Contracting, Source Selection, Administration of Service Contracts, Contingency Contracting, Negotiation Techniques, and Contract Administration.

Recommendations were made in the research discussed above for a three-phased approach to training inexperienced personnel: (1) a comprehensive core block of instruction on incentive contracting for Defense Acquisition Workforce Improvement Act (DAWIA) Level II business and technical personnel; (2) just-in-time training using a continuous learning module on incentives; and (3) lessons learned in a community of practice (COP) or in classroom teaching from within or by an institution such as the Defense Acquisition University (DAU). It was recommended that entire acquisition teams should participate in the third phase together to develop teamwork in the learning process.

Administration of award-fee contracts is time and resource intensive, and allocating time for training places additional demands on DoD managers and contracting personnel. Understanding and applying the laws, regulations, guidance, instructions, and directives is difficult and demanding, with the additional burden of the

current climate of sequestration, furloughs, and budget cuts. Investing resources for training is of paramount importance to decreasing waste and inefficiencies in award-fee contracting.

THIS PAGE INTENTIONALLY LEFT BLANK

IV. CONCLUSION AND RECOMMENDATIONS

A. GENERAL OVERVIEW OF FINDINGS

The success rate and risk level of DoD award-fee contracts depends on many resources and factors, including funding, technology, leadership, and agency or military service culture. Each of these factors can significantly alter the final desired outcome. The most critical element for cost-effective solutions to all DoD contracting, including award-fee contracting, is adequate training of the acquisition workforce. Although award-fee contracts represent a relatively small portion of overall government contracts, the amount of money involved in DoD contracts more than justifies a commitment of sufficient resources to training acquisition personnel.

B. RECOMMENDATIONS

As recommended by the GAO reports, in order to improve the usage of award-fee contracts within the DoD, the regulation guidance and agency guidance need to be more comprehensive, consistent, and more detailed on how to administer and accurately evaluate award-fee contracts.

To achieve this goal of conducting cost-saving, effective, and high-quality performance on award-fee contracts, contracting agencies must have highly-trained contracting officers and contracting specialists. Each agency must develop a standard operating plan and procedures guidance which registers throughout the contracting agencies. The guidance for award-fee contracts needs to be detailed and clear in the evaluation procedures and the administration of fees awarded to the contractor. In simple terms, the “guesswork” needs to be completely removed from this form of contracting in order for award-fee contracts to do what they were designed to do, as motivator to the contractor and a tool for the federal government to achieve the desired objectives in a cost-effective manner.

Ultimately, there is a need to unify guidance institutionally and train the acquisition workforce adequately on the development, management, and administration of award-fee contracts and the benefits of utilizing this type contract vehicle for the

DoD in federal government contracting. Training and development of personnel would allow for more objective assessments in determination of award fees and therefore reduce risk, increase efficiency and effectiveness, and obtain the desired outcomes for the DoD and the federal government.

LIST OF REFERENCES

- Carter, A.B., (December 2008). *Department of defense instruction 5000.2*. “Operation of the defense acquisition system.” Washington, DC: Department of Defense.
- Cibinic, J., Nash, R., & Yukins, C. (September 2011). “Formation of government contracts,” (4th ed.). Washington, DC; The George Washington University.
- Acquisition University. (May 15, 2013). *Defense acquisition guidebook*. Retrieved from <https://akss.dau.mil/dag/>
- Defense procurement and Acquisition Policy. (December 20, 2013). *Defense federal acquisition regulation supplement*. Retrieved from www.acq.osd.mil/dpap/dars/dfarspgi/current/index.html
- Department of Defense. (October 2006) “Earned value management implementation guide.” Washington, DC: Author. Retrieved from <http://guidebook.dcm.mil/79/EVMIG.doc> Federal Acquisition Regulation (FAR). General Services Administration, issued March 2005 (including amendments through FAC2005-71) effective Nov. 25. 2013. Retrieved from <https://www.acquisition.gov/far>
- Gilbreth, A.S., & Hubbard, S. (July 2008). “How to make incentive and award fees work.” *Defense Acquisition Review Journal*. July 1, 2008: 132–149. <http://www.dau.mil/pubcats/PubsCats/>
- Government Accountability Office (GAO). (July 2013). “*Actions needed to improve administration of the provider performance pay and award systems*” (GAO-13-536). Washington, DC: Author. Retrieved from <http://www.gao.gov/assets/660/656185>
- . (December 2005). “*Defense acquisition: DoD has paid billions in award and incentive fees regardless of acquisition outcomes*” (GAO-06-66). Washington, DC: Author. Retrieved from <http://www.gao.gov/new.items/d0666.pdf>
- . (August 2009). “*Federal contracting: application of OMB guidance can improve use of award fee contracts*” (GAO-09-839T). Washington, DC: Author. Retrieved from <http://www.gao.gov/assets/130/123188.pdf>
- . (May 2009). “*Federal contracting: guidance on award fees has led to better practices but is not consistently applied*” (GAO-09-630). Washington, DC: Author. Retrieved from <http://www.gao.gov/new.items/d09630.pdf>

- . (March 2011). *"Report to congressional addressees: opportunities to reduce potential duplication in government programs, save tax dollars, and enhance revenue"* (GAO-11-318SP). Washington, DC: Author. Retrieved from <http://www.gao.gov/new.items/d11318sp.pdf>
- Incentive contracting—Incentives, award fee, award term, (n.d.). In *ACQuipedia*. Retrieved from <https://dap.dau.mil/acquipedia/Pages/ArticlesDetails.aspx?aid=1c0fe484-43f8-4149-97bafefdf8ae>
- Manuel, K.M. (October 2010). "Contract types: An overview of the legal requirements and issues." Retrieved from <http://www.fas.org/crs/misc/R41168.pdf>
- National Defense Authorization Act for Fiscal Year 2008, Pub. L. No. 110-181 122 Stat. 3. (2008). Retrieved from <http://www.asq.osd.mil/dpap>
- Office of the Under Secretary of Defense. (January 2007). *"Proper use of award fees for achieving program outcomes should be improved"* (GAO-07-58). Washington, DC; Government Accountability Office. Author. Retrieved from <http://www.gao.gov/assets/260/255190.pdf>
- Schwartz, M. & Church, J. (2011). *Department of defense's use of contractors to support military operations: Background, analysis, and issues for Congress*. (CRS Report No. R43074). Washington, DC: Library of Congress. Congressional Research Service. Retrieved from <http://www.fas.org/sgp/crs/natsec/R43074.pdf>
- Tremaine, R.L. (December 2008). "Incentive contracts: The attributes that matter most in driving favorable outcomes," *Defense Acquisition Review Journal*, 216–238. Retrieved from <http://www.dau.mil/pubcats/PubsCats/ARJ49/tremaine.pdf>

INITIAL DISTRIBUTION LIST

1. Defense Technical Information Center
Ft. Belvoir, Virginia
2. Dudley Knox Library
Naval Postgraduate School
Monterey, California